

Internal Revenue Service

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Person To Contact:

, ID No.

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CC:PSI:B02

PLR-132627-06

Date:

September 06, 2006

X =

Y =

A =

B =

D1 =

D2 =

Dear :

This responds to a letter received July 3, 2006, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated and made an election to be treated as an S corporation effective D1. As of D1, A and B owned all of the X stock. On D2, both A and B transferred all of their X stock to Y, a multiple-member limited liability company taxable as a partnership owned by A and B in the same proportions as X. Y was not an eligible S corporation shareholder as of the date of transfer, and X's S corporation election terminated on D2. The X stock held by Y has been reacquired by A and B.

X represents that its shareholders were unaware of the consequences when the transfer of stock to Y was made. X further represents that the shareholders' actions were not motivated by tax avoidance or retroactive tax planning. X, A, B, and Y have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D2 and that the termination was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1361(d). The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items

of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Specifically, this ruling is conditioned upon A and B being treating as the owners of the X stock held by Y effective D2, and thereafter. A and B must report their pro-rata shares of the items described above on their individual federal income tax returns. If they fail to do so, this ruling is null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes